THE RISK MANAGEMENT ASSOCIATION
Serving the Financial Services Industry

1801 MARKET STREET, SUITE 300 • PHILADELPHIA, PA 19103 • 215-446-4000 • FAX 215-446-4101 • www.rmahq.org

May 24, 2012

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, D.C. 20551

AMAG Supplemental Response
2012 Agency Information Collection Activities
Operational Risk Data Reporting FR Y-14A/Q/M – OMB Nos. 7100-0341 and 7100-0319

Dear Ms. Johnson:

This letter and attachments comprise a Supplemental Response from the Advanced Measurement Approaches Group (AMAG)[1] on proposed changes to the Operational Risk aspects of Agency Information Collection Activities under FR Y-14A[2].

To be clear, *the AMAG stands by its original response of April 23, 2012 and objection to providing legal reserve data as part of the FR Y-14A/Q/M*.

Background

The Federal Reserve Board (FRB) is requesting that AMA banks submit operational risk loss data based on a new quarterly operational risk loss data collection template. The FRB's request encompasses all operational risk loss data, including reserves for pending litigation, because the reserves tend to have a significant impact on the measurement of operational risk. Among other concerns in our April 23, 2012 letter, AMAG highlighted the extremely confidential and sensitive nature of the legal reserve

[1] The Advanced Measurement Approaches Group (AMAG) was formed in 2005 by the Risk Management Association (RMA) to share industry views on aspects of Advanced Measurement Approaches (AMA) implementation with the U.S. financial services federal regulatory agencies. The members of AMAG are listed in the Attachment to this letter. They are listed for identification purposes only. This letter and attachment do not necessarily represent the views of RMA's institutional membership at large, or the views of the individual institutions whose staff have participated in the AMAG.

[2] Generally speaking, AMAG member firms understand and appreciate the regulatory community's interest and needs for collecting actual loss data. The Federal Reserve has stated its goals for the change as (1) assessing BHC's operational loss exposures in relation to the risks faced by them, (2) ensuring safety and soundness, (3) developing and calibrating supervisory stress test models, (4) evaluating the projections that BHCs' submit as part of the FR Y-14A, and (5) supporting continuous monitoring and analysis of BHCs' operational loss activity and trends. Despite its support in concept, AMAG has concerns about some of the details of implementing this new proposal relative to FR Y-14A/Q submission requirements.

data that would be required as part of quarterly submissions of operational risk loss data sets on the collection template, and explained why it would be inappropriate to include such information in these data sets.

Excerpt from AMAG April 23, 2012 Response

"AMAG submits that requiring banks to disclose their legal reserves for pending and probable litigation claims in connection with CCAR would be unwise, unsound and highly prejudicial, and should not be pursued. Legal reserves for litigation claims are established by banks in receiving legal advice from their legal counsel and often, if not always, entail the exercise of significant professional judgment by experienced legal counsel in weighing the relative strengths of claims and defenses in light of existing law and factual developments. Hence, legal reserves are both privileged and highly confidential. Any public disclosure of legal reserves would subject banks to significant prejudice, as it would both inform their adversaries of how the bank weighs the strengths/weaknesses of the subject claims and establish a floor for plaintiffs' settlement demands on those claims. Potential prejudice to the banks also looms in the risk that adversaries could seek to introduce the reserves as evidence in the litigation, as admissions of liability or the amount of damages. Furthermore, were the banks required to provide these data to the Federal Reserve as part of the CCAR exercise, there can be no assurance that it would remain confidential. CCAR requires massive efforts by the Federal Reserve, with a large number of staff devoted to analyzing all of the data provided by banks. Wide dissemination of reserve data, even within the Federal Reserve, necessarily reduces the ability to maintain strict confidentiality, and the prospect of inadvertent or erroneous disclosure is substantial. Along the same lines, it would be difficult, at best, for the Federal Reserve to resist any request by Congress to obtain these data, which would then be susceptible to broad public dissemination. The severe prejudice to banks that disclosure would entail, coupled with the substantial risk of that very result, militates strongly against requiring that banks disclose reserves data as part of their CCAR submissions."

Subsequent Dialogue

Consistent with AMAG's mission, the Group appreciates and welcomes the opportunity to engage in a dialogue with the regulatory community about the successful implementation of the Advanced Measurement Approaches under Basel and the safety and soundness of the U.S. banking system.

Following AMAG's April 23rd response, the Federal Reserve contacted The Risk Management Association (RMA), sponsor of AMAG, for clarification of the Group's response on the question of including legal reserves in CCAR submissions.

As part of a subsequent dialogue, the Federal Reserve made two requests. First, AMAG was asked to consider whether a reduced scope of legal reserve data (i.e., three data fields, namely amount, business line / event type, and a "rough" date) would satisfy member banks' sufficiently in order to revise its response. Second, the Federal Reserve asked whether less frequent reporting would lessen banks' concerns. Unfortunately neither of these options would provide the assurance of confidentiality. The risk of inadvertent disclosure or legal discovery by other U.S. agencies, governmental bodies, or third parties, including plaintiffs, is simply too real. This risk is even more untenable, of course, in view of the fact that bodies of the U.S. government may be plaintiffs in cases against the very banks in question.

Analytic Alternatives

Although these suggestions remain untenable, AMAG member institutions believe that a solution may be possible that protects these critical data sets in the interest of their stakeholders – depositors, other customers, shareholders, bondholders, and employees among them – without diminishing the stated objectives of the Federal Reserve System. In the spirit of continuing a dialogue and seeking potential solutions to this apparent impasse, AMAG offers two possible analytical alternatives that have been developed by several of the AMAG banks.

AMAG recognizes that these options are not without challenges for both banks and regulators alike. We trust that industry and FRB can work toward an alternative that satisfies the sensitivities of both parties with respect to proprietary information. Specifically, AMAG is prepared to work with the FRB to assess the merits and feasibility of the following proposals in the spirit of satisfying U.S. banking agencies' need for insight into banks' operational risk exposures, while respecting the banks' and their stakeholders' own need for confidentiality of these critical data sets.

Following are high-level descriptions of the suggested alternatives for further exploration:

Alternative #1 – *Provide "processed" rather than highly confidential "raw" loss reserve data*

Rather than provide the "raw" loss data to the FRB, the AMAG banks could provide "processed" data. Undoubtedly, the FRB has plans to use the raw loss event data within some sort of modeling process. We assume that the end-to-end modeling process includes a series of analytical / quantitative tasks. Our proposal would be for the AMAG banks to perform some of the initial analytical / quantitative tasks and submit the output to the FRB. Then, the FRB could take this output and perform the remaining tasks to complete the modeling process and produce the final results.

It is difficult to determine the exact nature of the tasks to be performed by the AMAG banks without knowledge of the FRB's modeling process. However, here are some examples on how this alternative approach could work based on some typical operational risk modeling processes.

Example A: LDA-type modeling which focuses on determining parametric frequency and severity distributions using the empirical loss data

- Determining Frequency distribution parameters: Loss amount information is not necessary for frequency modeling; therefore the AMAG banks could provide the number of loss event for each unit of measure without providing loss amount. This information would not compromise the confidentiality of the reserve data and would not impede the FRB in modeling frequency of loss.
- Determining Severity Distribution parameters: Loss amount information is critical to determining severity distribution parameters. Therefore, the proposal would be for the FRB to provide the AMAG banks with the specifications on how the loss data should be fitted. The AMAG banks would be responsible for running the fitting process and submitting the results (fitted distribution parameters for each UOM). The loss amount for individual events would not be submitted and the

confidentiality of the reserve data would not be jeopardized. In addition, AMAG banks could provide other statistics such as goodness-of-fit test results and other statistical properties of the empirical distribution (mean mode, median, variance, etc.)

Example B: Panel Regression analysis between Frequency of loss and macroeconomic factors (in line with the model used by the FRB for the recent CCAR analysis)

- This type of analysis would not require loss amount information as the regression analysis is performed against the frequency of loss. Therefore, AMAG banks could submit the loss data without loss amounts.
- Once the number of losses for a given stress period is determined, the FRB would need some estimate of severity. In the recent CCAR analysis, the FRB used "sample averages by event type for each BHC" as the estimate of severity. The AMAG banks could provide these statistics (along with other statistics) for each UOM without compromising the confidentiality of the reserve information.

Alternative #2 – *IT Solution – Data sets are not submitted, rather they remain hosted by the individual banks and accessed by the FRB remotely*

In this alternative, AMAG banks would create a secure environment within their own networks and authorized FRB personnel would access the data to perform the quantitative analysis. FRB personnel could perform the desired analysis but would not be able to extract the raw data. They would be able to extract the results of the analysis.

AMAG banks would have a significant amount of control over who accesses the information and an audit trail / log of the activity. That is, reserve loss amounts would be disclosed to FRB personnel, but the information would not leave the AMAG bank's network

Once again, these options are provided in the spirit of continuing a dialogue between the industry and regulatory community, and in seeking a solution to the data collection problem.

Thank you, on behalf of AMAG, for the opportunity to clarify our previous response and offer possible solutions. The AMAG would be pleased to continue a dialogue about these issues.

Please contact us accordingly.

Sincerely,

Robin L. Phillips
Chairman,
Advanced Measurement Approaches Group

<u>Attachment</u>
About the AMA Group

Attachment

About the AMA Group

The Advanced Measurement Approaches Group (AMAG) was formed in 2005 by the Risk Management Association (RMA) at the suggestion of the U.S. AMA-BQT (formerly the Inter-Agency Working Group on Operational Risk). The RMA is a member-driven professional association whose purpose is to advance the use of sound risk management principles in the financial services industry.

The purpose of the AMAG is to share industry views on aspects of Advanced Measurement Approaches (AMA) implementation with the U.S. financial services federal regulatory agencies. The Group consists of operational risk management professionals working at financial service organizations throughout the United States. The AMAG is open to any financial institution regulated in the United States that is either mandated, opting in, or considering opting in to AMA. A senior officer responsible for operational risk management serves as the primary representative of each member institution on the AMAG. Of the US financial service institutions that are currently viewed as mandatory or opt-in AMA institutions; nineteen were members of the AMAG at the time of this writing.

The members of AMAG are listed below. They are provided for identification purposes only. This paper does not necessarily represent the views of RMA's institutional membership at large, or the views of the individual institutions whose staff have participated in the AMAG.

Bank of America / Merrill Lynch
Bank of the West
BMO Financial Group
BNY Mellon
Capital One Bank
Citizens Bank
Deutsche Bank
Goldman Sachs
HSBC
JP Morgan Chase
Keycorp
Morgan Stanley
Northern Trust
PNC
State Street Corporation
SunTrust
TD Bank Financial Group
Union Bank
Wells Fargo

Support for the AMAG is provided by RMA and Operational Risk Advisors LLC.